

Memorandum

To: Chair Weisenmiller
Commissioner Scott
Commissioner Douglas
Commissioner Hochschild
Commissioner McAllister

Date: November 2, 2015

From: Allan L. Ward, II, Assistant Chief Counsel, prepared at the request of Robert Oglesby,
Executive Director

Subject: Staff Recommendation to Seek an Order to Terminate with Cause Grant Agreement ARV-12-033 with Mendota Bioenergy, LLC

I. Introduction

Energy Commission staff seeks an order from the Energy Commission to terminate with cause grant agreement ARV-12-033 (Agreement) with Mendota Bioenergy, LLC (Mendota). Staff seek termination of the Agreement with cause because Mendota committed multiple, significant breaches of the Agreement terms.

II. Statement of Facts

In March, 2013, the Commission and Mendota entered into the Agreement. (**Attachment 1**). The Agreement is funded under the Commission's Alternative and Renewable Fuel and Vehicle Technology Program (ARFVTP) and was selected as part of a competitive solicitation.

The Commission and Mendota have amended the Agreement several times. (**Attachments 2-4**). Under the amended Agreement, the Commission agreed to provide \$4,998,399, and Mendota agreed to provide \$6,595,724 in match funding. (**Attachment 4, Exhibit B-1a Task Summary, p. 1**).

The amended Agreement's objectives include:

Design, construct, and operate a pilot-scale plant that converts approximately 2400 tons per year of carbon-optimized energy beets into 60,000 gallons of 200-proof ethanol. (**Attachment 4, Exhibit A, Scope of Work, p. 6**)

The project is located at Red Rock Ranch in Five Points, California and involves utilizing energy beets grown in Fresno and Merced counties.

Mendota submitted invoices between September and December 2013 requesting total payment of \$1,777,873¹ for expenditures with subcontractor Easy Energy Systems (EES). (**Attachments 5 and**

¹ Made up of \$317,504 from Invoice #6 plus \$1,460,369 from Invoice #7A. Although the Easy Energy Systems Invoice included in Invoice #6 states \$313,504, Mendota claimed and was paid \$317,504 for it.

6²). Based on these EES invoices, Fuels and Transportation Division (FTD) staff approved the payments to Mendota.

At a meeting with Mendota in November 2014, almost a year after submitting and receiving payment for the EES invoices, Mendota orally informed FTD staff that it had approximately \$1 million of Energy Commission funds in its bank account from the EES invoices. When FTD staff asked about the funds, Mendota stated that it had paid EES \$750,000 but not the remaining amount and that EES breached their agreement.

The Commission and Mendota continued to communicate about the EES invoices and the EES-invoiced funds Mendota said it had in its bank account. (**Attachment 7**).

On December 1, 2014, FTD staff sent an email to Mendota that states:

As discussed in our meeting, the Energy Commission requests that Mendota return the ~\$1.1 million in undisbursed funds immediately. (**Attachment 8**).

The email also states:

Since grants funds are reimbursed in arrears (i.e., after project expenditures have been made), the repayment of these funds should not impact the project. These funds will be put back into the grant award and disbursed for future project expenditures in accordance with the terms and conditions. (**Attachment 8**).

Mendota replied by email on the same day, stating:

The Mendota Board will need to confer with Counsel Matt Hoffman on CEC Staff request to return the unexpended Task 6 “Construction” funds for work currently underway, by December 8th.

This precipitous action could have serious adverse effect on the project’s viability. (**Attachment 9**).

On December 11, 2014, Mendota sent a letter to FTD staff stating:

The work underway at Red Rock Ranch requires more timely payments than is possible given the Commission’s 75 calendar day payment cycle since ARV 12-033 project inception. Mendota notes that acquiring additional working capital is critical given these project developments and the Board is taking immediate actions to remedy the situation. These elements make it problematic to effect a re-payment of that magnitude to the Commission without considerably more dialogue. (**Attachment 10**³).

On December 15, 2014, the Commission Agreement Officer issued a Stop Work Order (**Attachment 11**) to Mendota under Agreement Term and Condition Section 14 (**Attachment 1, Exhibit C, p. 10**).

On January 15, 2015, the Commission’s Chief Counsel’s Office (CCO) sent a letter to Mendota stating:

² Attachments 5 and 6 only contain the invoice cover page and invoices from Easy Energy Systems.

³ For brevity, the attachments to this letter were not included in Attachment 10.

Under the Grant entered into between the Commission and Mendota, Mendota invoiced for and the Commission paid to Mendota approximately \$1.7 million for equipment. Mendota was going to receive the equipment from Easy Energy, Corp., but had issues with Easy Energy's performance, and is no longer seeking equipment from it. Mendota reimbursed Easy Energy approximately \$750,000, leaving a balance of \$1,023,873 in funds received from the Commission. The Commission has twice requested repayment from Mendota, and Mendota has refused. Yet, when representatives from Mendota met with Commission staff on November 13, 2014, Mendota said that the remaining funds were in Mendota's bank account. **(Attachment 12).**

The letter also states:

The purpose of this letter is to demand that Mendota Bioenergy, LLC ("Mendota"):

1. Repay \$1,023,873 to the California Energy Commission ("Commission") by 5 p.m. Tuesday, January 20, 2015, or repay as much of that amount that remains unspent on Grant ARV-12-033 ("Grant").
2. Provide documents by 5 p.m. Friday, January 30, 2015 accounting for any of the \$1,023,873 not repaid to the Commission per #1.

On or about January 20, 2015, Mendota repaid \$300,000 to the Commission.

On January 28, 2015, Mendota sent a letter to the Commission and included what it described as a "transaction report detailing all expenditures of MBLLC in connection with the Grant...." **(Attachment 13).**

On February 5, 2015, the Commission's Chief Counsel's Office (CCO) sent a letter to Mendota stating:

After review of the Custom Transaction Detail Report, Commission staff finds that the accounting for the \$732,873 not repaid to the Commission is insufficient to confirm the appropriateness of the expenditures.... **(Attachment 14).**

On February 13, Mendota submitted additional documentation to the Commission, including a "summary of all...expenditures...bank statements and cancelled checks..." but not receipts, invoices, or other backup documentation. **(Attachment 15⁴).**

On April 22, 2015, the Commission's Office of Audits, Investigations, and Program Review (AIPR) issued its final audit report about its analysis of this Agreement. **(Attachment 16).** Among other recommendations, AIPR's final audit report recommended that Mendota repay to the Commission \$1,477,873⁵ from the EES-invoiced funds.

On May 28, 2015, FTD and CCO staff met with representatives of Mendota. Mendota requested another chance to document expenditures and requested until June 30, 2015, to provide this

⁴ For brevity, the bank statements and copies of checks have been omitted from this Attachment.

⁵ \$1,477,873 comes from the sum of \$727,873 and \$750,000, respectively from Observation 1, Recommendation A, p. 4 and Observation 2, Recommendation A, p. 4.

additional documentation. FTD staff agreed to provide this additional time and sent an email (**Attachment 17**) stating:

Thank you again for meeting with us today. We felt as this was a productive meeting. As promised, attached is a listing of the disallowed expenditures under invoices #20-23 which are currently disputed.

As a reminder, Mendota is on point to deliver source documentation of expenditures and proof of payment to offset the \$1,285,308.98 owed to the Energy Commission (per CEC's calculation). Please remember, these expenditures must be:

- Consistent with the Scope of Work
- Consistent with the Budget
- Consistent with the Stop Work Order
- Not duplicative with previously approved expenditures (or pending approved expenditures under Invoices #20-23).

Staff calculated the \$1,285,308.98 for which Mendota owed repayment or documentation as follows. Mendota invoiced for and received \$1,773,873 for EES expenses. Mendota later paid back \$300,000 to the Commission, leaving a balance of \$1,473,873. Staff then subtracted the allowable expenses claimed under disputed invoices 20-23 to arrive at \$1,285,308.98. This amount includes the \$750,000 that Mendota paid to EES because it was not paid in accordance with the Easy Energy invoices submitted to the Commission. Instead, it was paid as part of a later services agreement with Easy Energy without Mendota providing the required backup documentation for the expenses.

On June 30, 2015, Mendota submitted additional documentation to FTD staff and a proposal for moving forward. (**Attachment 18**⁶). The proposal requires the Commission to pay Mendota approximately \$240,000⁷ plus the currently held retention. The proposal did not include the Commission recovering anything of the \$750,000 Mendota paid to EES and did not include the required source documentation of \$1,285,308.98 of expenditures.

On July 9, 2015, Energy Commission Executive Director Robert Oglesby sent a response rejecting Mendota's proposal, explaining how Mendota's documentation was still insufficient, and reasserting the Energy Commission's demand for payment. (**Attachment 19**).

On August 6, 2015, Mendota sent a letter to the Commission stating:

At this point, MBLLC is completely out of funds. As a result, even if MBLLC agreed with the CEC's findings on this matter (MBLLC continues to deny those findings), MBLLC has no ability to repay any further funds to the CEC. (**Attachment 20**).

III. Termination with Cause

Agreement Term and Condition Section 13⁸ allows the Commission to terminate the Agreement with cause under certain conditions:

⁶ Attachment 18 does not include the litigation analysis that Mendota submitted with this letter.

⁷ Calculated from \$771,000 minus \$531,308.97.

⁸ See Attachment 1, Exhibit C, Section 13, p. 10.

With Cause

In the event of any breach by the Recipient of the conditions set forth in this Agreement, this Agreement may be terminated for cause upon five (5) days written notice to the Recipient, without prejudice to any of the Commission's legal remedies.

IV. Analysis

The facts in this situation meet all of the Agreement term's requirements allowing the Commission to terminate for cause.

A. 5-Day Notice Requirement

Staff met the five-day notice requirement in Agreement term and condition 13. Staff sent written notice about this proposed termination with cause to Mendota on November 2, 2015, which is five or more days prior to the November 12, 2015 business meeting at which the Commission considers this request. (**Attachment 21**).

B. Breaches of the Agreement

Mendota committed multiple breaches of the Agreement terms and conditions, including the following:

1. Invoicing and receiving \$1,777,873 for expenses for its subcontractor EES and then using \$727,873 for the funds for non-EES expenses without submitting required documentation and without Commission review and approval.

Agreement Term and Condition Section 17 states:

The Energy Commission agrees to reimburse the Recipient for actual allowable expenditures incurred in accordance with the Budget.

Payments will generally be made on a reimbursement basis for Recipient expenditures, i.e., after the Recipient has incurred the cost for a service, product, supplies, or other approved budget item.⁹

It also states:

Documentation

All payment requests must be submitted using a completed Payment Request form (Exhibit C, Attachment 1). This form must be accompanied by an itemized list of all charges and copies of all receipts or invoices necessary to document these charges for both Commission and match share, including backup documentation for actual expenditures, such as time cards, vendor invoices, and proof of payment. Any payment request that is submitted without the itemization will not be authorized. If the itemization or

⁹ Attachment 1, Exhibit C, Section 17, p. 12.

documentation is incomplete, inadequate, or inaccurate, the CAM will inform the Recipient and hold the invoice until all required information is received or corrected.¹⁰

Mendota invoiced the Commission for \$1,777,873 for EES expenses, which induced the Commission to pay this amount to Mendota. Of this \$1,777,873, Mendota paid \$750,000 to EES and repaid \$300,000 to the Commission, leaving a balance of \$727,873 of funds paid to Mendota for invoiced EES expenses.

Mendota did not spend the \$727,873 of EES-invoiced funds on EES expenses. Mendota only paid \$750,000 to EES, and its August 6, 2015, letter states that it “is completely out of funds.”¹¹

Mendota breached the Agreement terms by spending \$727,873 of Commission funds on non-EES expenses without first submitting payment requests and required backup documentation.

This breach is significant because it prevented the Commission from agreed upon oversight and approval of \$727,873 of its funds before Mendota spent the funds.

Mendota disagrees with this characterization of its actions. In its response to the audit report, Mendota states:

The CEC advanced MBLLC the indicated amount of \$1,777,873 based on a partial equipment invoice submitted by EES for the re-engineering and re-tooling of its modular ethanol plan in Emmetsburg, Iowa. Equipment funds were advanced because the CEC’s payable timetable of between 75 to 158 days from submittal to payment would not support any normal construction activities or meet the aggressive calendar for completion of the project.¹²

Mendota also states (underlining in original):

Quoting directly from Section 17 of the Grant’s Terms and Conditions (Payment of Funds)...the Section states “Payments will generally be made on a reimbursement basis for Recipient expenditures, i.e., after the Recipient incurred the cost for a service, product, supplies, or other approved budget item.” The operative word in this Section is “generally” and in the case of MBLLC’s significant expenditures for equipment an advance payment was made by the CEC to support the project’s aggressive timetable.¹³

Contrary to Mendota’s assertion, FTD staff did not approve an advance of funds to Mendota. Mendota never made a request for an advance of funds nor do the documents Mendota submitted for payment of EES expenses indicate that the request was for an advance. To the contrary, the EES invoices appear to be for actual or incurred expenditures, even including “Ship” dates making it appear that the equipment was shipped.¹⁴

Mendota’s reliance upon the word “generally” in Agreement Term and Condition Section 17 to support its position is incorrect. As indicated above, Mendota states:

¹⁰ Attachment 1, Exhibit C, Section 17, p. 13.

¹¹ Attachment 20.

¹² Attachment 16, Attachment A, p. 4.

¹³ Attachment 16, Attachment A, p. 6.

¹⁴ Attachments 5 and 6.

The operative word in this Section is “generally” and in the case of MBLLC’s significant expenditures for equipment an advance payment was made by the CEC to support the project’s aggressive timetable.¹⁵

Health and Safety Code Section 44270 et seq. govern the ARFVTP Program, under which the Mendota Agreement was made. Section 44272(g)(3) states:

(g) The commission may do all of the following...

(3) Advance funds, pursuant to an agreement with the commission, to any of the following:

(A) A public entity.

(B) A recipient to enable it to make advance payments to a public entity that is a subrecipient of the funds and under a binding and enforceable subagreement with the recipient.

(C) An administrator of a block grant program.

Section 44272(g)(3) is incorporated by reference to the Agreement by Agreement Term and Condition Section 3, which states:

Funding Limitations

Any federal, State, and local laws and regulations applicable to your project not expressly listed in this Agreement are incorporated herein as part of this Agreement.

Under Section 44272(g)(3), the Commission has the authority to advance funds in the situations listed, otherwise it must pay on a reimbursement basis. Thus, generally the Commission pays on a reimbursement basis unless one of the situations in Section 44272(g)(3) exists and the Commission approves an advance of funds.

Mendota’s payment requests for EES expenses do not meet any of the criteria in Section 44272(g)(3) that would authorize the Commission to advance it funds. Neither Mendota nor EES are public entities, and Mendota is not an administrator of a block grant program under this Agreement.

Lastly regarding this breach, for the sake of argument only, even if the Commission had advanced the funds as Mendota claimed, Mendota still breached the Agreement’s terms. Mendota invoiced for and received funds for EES expenses. Regardless of whether an advance was made, Mendota’s use of EES-invoiced expenses for non-EES expenses violates Agreement Term and Condition Section 17 because Mendota did not first submit a payment request – advance or otherwise – with the required backup documentation for the \$727,873 of non-EES expenditures it paid from EES-invoiced funds.

2. A second breach by Mendota involves its continued lack of required documentation for \$1,285,308 in expenditures of Commission funds.

The Agreement terms state (underlining added):

¹⁵ Attachment 16, Attachment A, p. 6.

The Energy Commission agrees to reimburse the Recipient for actual allowable expenditures incurred in accordance with the Budget. The rates in the Budget are rate caps, or the maximum amount allowed to be billed. The Recipient can only bill for actual expenses incurred at the Recipient's actual direct labor rate(s), fringe benefit rate(s), and indirect rate(s), not to exceed the rates specified in the Budget.

Payments will generally be made on a reimbursement basis for Recipient expenditures, i.e., after the Recipient has incurred the cost for a service, product, supplies, or other approved budget item. No reimbursement for food or beverages shall be made other than allowable per diem charges.

Documentation

All payment requests must be submitted using a completed Payment Request form (Exhibit C, Attachment 1). This form must be accompanied by an itemized list of all charges and copies of all receipts or invoices necessary to document these charges for both Commission and match share, including backup documentation for actual expenditures, such as time cards, vendor invoices, and proof of payment. Any payment request that is submitted without the itemization will not be authorized. If the itemization or documentation is incomplete, inadequate, or inaccurate, the CAM will inform the Recipient and hold the invoice until all required information is received or corrected.¹⁶

In working with Mendota to resolve issues involving the Commission funds it spent from the EES invoices, Commission staff asked multiple times for expenditure documentation. For example, a January 15, 2015 letter from Commission's CCO states:

The purpose of this letter is to demand that Mendota Bioenergy, LLC ("Mendota"):

1. Repay \$1,023,873 to the California Energy Commission ("Commission") by 5 p.m. Tuesday, January 20, 2015, or repay as much of that amount that remains unspent on Grant ARV-12-033 ("Grant").
2. Provide documents by 5 p.m. Friday, January 30, 2015 accounting for any of the \$1,023,873 not repaid to the Commission per #1.¹⁷

Mendota responded to this request on February 13, 2015 and stated (underlining added):

Enclosed with this letter is a summary of all MBLLC expenditures as either reimbursable or non-reimbursable under out interpretation of the terms of Grant ARV-12-033 (the "Grant"); In addition, we have enclosed with these letter bank statements and cancelled checks with respect to all such expenditures.¹⁸

Although this "summary" provided an "itemized list" of charges, it did not meet the following requirements of Agreement Term and Condition Section 17: "copies of all receipts or invoices necessary to document these charges for both Commission and match share, including backup

¹⁶ Attachment 1, Exhibit C, Section 17, p. 12.

¹⁷ Attachment 12.

¹⁸ Attachment 15.

documentation for actual expenditures, such as time cards, vendor invoices, and proof of payment.”

After a May 28, 2015, meeting between Commission staff and Mendota, Commission staff sent an email to Mendota stating (underlining added):

Thank you again for meeting with us today. We felt as this was a productive meeting. As promised, attached is a listing of the disallowed expenditures under invoices #20-23 which are currently disputed.

As a reminder, Mendota is on point to deliver source documentation of expenditures and proof of payment to offset the \$1,285,308.98 owed to the Energy Commission (per CEC’s calculation). Please remember, these expenditures must be:

- Consistent with the Scope of Work
- Consistent with the Budget
- Consistent with the Stop Work Order
- Not duplicative with previously approved expenditures (or pending approved expenditures under Invoices #20-23).¹⁹

Mendota’s response on June 30, 2015, lacked the information requested by FTD staff, which was explained to Mendota in a July 9, 2015 letter:

After careful examination of the additional documentation provided by Mendota on June 30, 2015, Energy Commission staff concluded that Mendota’s documentation was not responsive, failing to adhere to the agreed upon requirements. The submitted documentation does not include source documentation and proof of payment to demonstrate the expenditures are eligible, not duplicative, and consistent with the Scope of Work, Budget, and Stop Work Order.²⁰

To date, Mendota has not provided the documentation required under the Agreement terms. This breach is significant for two reasons. First, the costs are unallowable until the documentation is provided because Commission Agreement Term and Condition Section 17 states “If the itemization or documentation is incomplete, inadequate, or inaccurate, the CAM will inform the Recipient and hold the invoice until all required information is received or corrected.” Second, Agreement Term and Condition Section 17 also states, “The Energy Commission agrees to reimburse the Recipient for actual allowable expenditures incurred in accordance with the Budget.” Without the required documentation, the Commission cannot confirm in the agreed upon manner whether Mendota properly spent \$1,285,308 of Commission funds in accordance with the budget.

V. Recommendation

For the reasons stated in this memo, Energy Commission staff recommends that the Energy Commission terminate agreement ARV-12-033 with Mendota Bioenergy LLC with cause.

¹⁹ Attachment 17.

²⁰ Attachment 19.